No. 12,747

IN THE

United States Court of Appeals

For the Ninth Circuit

J. R. NORBERG, an individual doing business as Norberg Adjustment Bureau; HOPE D. PETTEY, WILLIAM B. DOLPH, ALICE HUSTON LEWIS, HELEN S. MARK, ELIZABETH N. BINGHAM, D. NORTH CLARK, EDWIN P. FRANKLIN, GLENNA G. DOLPH, individually and doing business as copartners under the firm name and style of KJBS Broadcasters,

Appellants,

vs.

PAUL W. RYAN, Trustee of the Estate of Brick O'Gold (a corporation),

Appellee.

Appeal from a Judgment of the United States District Court for the Northern District of California, dated August 9, 1950 and filed August 9, 1950.

APPELLANTS' OPENING BRIEF.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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APPELLANTS' OPENING BRIEF.

STATEMENT OF THE CASE AND QUESTIONS PRESENTED.

Appellant, J. R. Norberg, an individual doing business as Norberg Adjustment Bureau, in an attempt

to collect a claim filed in his office due a creditor of bankrupt corporation, called upon one of the bankrupt's stores for the first time on September 9, 1949 (Tr. p. 143). On that date a demand was made for the payment of the sum of $1,076.40 and appellant was told to call back the next day and pick up a check (Tr. pp. 143-144). Acting upon such request, appellant returned the next day for the purpose of collecting the money and then for the first time met the president of the corporation, a Mr. Paul Ludolph (Tr. p. 142), and appellant was then informed that the bankrupt did not have the ready cash in its possession and would have a check the following Monday (Tr. p. 145), and was also informed at that time that the corporation was not insolvent and would pay its bill (Tr. pp. 152, 155).

Mr. Ludolph testified that on Saturday, September 8, he first saw the appellant (September 8, 1949, was on a Thursday), and on such September 8, stated that he showed a financial statement which was prepared by its C.P.A. (Tr. pp. 32-33, 43). On September 12, 1949, appellant filed an action against the corporation and caused a writ of attachment to be issued and levied, and thereafter on October 9, 1949, caused a writ of execution to be levied upon the attached property and received the sum of $1,076.40 as full payment and satisfaction of the judgment obtained in said action.

The witness, Ludolph, further testified from the schedule in bankruptcy which was filed November 9,

1949, that the financial condition of the corporation was the same on September 12, 1949, as it was when the petition in bankruptcy was filed (Tr. pp. 29-30) and that there were balances due them from certain franchise stores (Tr. p. 47).

Such witness also admitted that he showed the appellant the financial statement of the corporation dated July 31, 1949 (Tr. pp. 32, 44-45), and which was introduced in evidence as Defendants' Exhibit "D" (Tr. p. 102). Such witness also admitted that the bankrupt corporation was attempting to secure an "R.F.C." loan (Tr. pp. 50-51, 53) and that the application for the R.F.C. loan was based upon such financial statement, Defendants' Exhibit "D" (Tr. pp. 54-55).

Mr. Ludolph's testimony also showed that the first time the appellant talked to him, he did *not* inform the appellant that they were insolvent, but stated that "it would ruin our chances to get any capital * * *" (Tr. pp. 33-34). (Emphasis and quotation ours.)

A Mr. Theodore A. Kolb, an attorney at law, who had some dealings with defendant corporation after the attachment was levied and before the petition in bankruptcy was filed, testified as a witness on behalf of the appellant herein, and stated that Mr. Ludolph admitted to him that in spite of a poor winter their business showed large gains each month and their business looked bright. (Tr. p. 73—Appellant's Exhibit "B" in evidence which was written on July 2, 1949), and that as late as August of 1949 they were

completely solvent but couldn't get their collections from accounts as fast as anticipated (Tr. pp. 82-83).

It appears that the only complaint made by the witness, Mr. Ludolph, was that the action filed by an accountant for the sum of $500.00 voided him of working capital (Tr. pp. 87 and 88). At the suggestion of Mr. Kolb, taking advantage of the bankruptcy statute, the witness further testified that Mr. Ludolph did not desire to take advantage of the bankruptcy statute, the reason "being because I am solvent", and again referred to the financial statement in evidence (Tr. pp. 88, 95, 98, 101).

Mr. Kolb further testified that the largest creditor of the bankrupt, the Samarkand Ice Cream Company, was also satisfied that the bankrupt corporation at that time was in a solvent condition (Tr. p. 90), and that another officer of the corporation, Miss Nellie Lee, also told Mr. Kolb that the corporation was solvent (Tr. pp. 94-95, 98-99, 101, 104).

Miss Nellie Lee, a witness on behalf of the plaintiff and an officer of the corporation, as aforesaid, admitted that the corporation "was in financial difficulties" (Tr. pp. 117, 122) (quotation ours), and didn't have the money to pay the obligation. It is to be noted that not a word was said about insolvency at that time by Miss Lee. Miss Lee also admitted that the financial statement (Exhibit "D") was prepared for the purpose of getting an R.F.C. loan (Tr. p. 128), and that it was a true and correct picture of the corporation and summary of the assets and lia-

bilities of the corporation (Tr. pp. 118-119). She also admitted that she informed both Mr. Kolb and the appellant herein that the corporation was *"sound"* (Tr. p. 132), and that the only concern of such witness was that at that time they did not have the money to pay the appellant (Tr. pp. 133-134).

Miss Lee also testified that the corporation had accounts receivable and that if they could collect them, they would be able to pay all creditors (Tr. pp. 131-132).

It will also be noted that the conversation with Mr. Kolb and the conversation between Mr. Kolb and Miss Lee and Mr. Ludolph in Mr. Kolb's office was *after* the attachment had been issued and levy made (Tr. pp. 124-125). The appellant herein corroborated the testimony of both Miss Lee and Mr. Kolb with reference to the financial statement that the corporation was in a solvent condition and that they were attempting to obtain an R.F.C. loan (Tr. pp. 151-152). Mr. Norberg also testified that bankruptcy was suggested by Mr. Kolb, but that both Miss Lee and Mr. Ludolph did not desire to file a petition in bankruptcy or reorganize the corporation, and as they stated, they were not insolvent but needed a little more time to convert their assets into cash (Tr. pp. 153, 155).

It appears that the Court at the very commencement of the case seemed to have made up its mind in the matter by its remarks made during the course of the trial, and before all of the evidence was introduced, as the Court seemed to indicate that Mr. Kolb

was "not satisfied with the situation" (Tr. p. 83), when such was not the fact. The Court also indicated that whatever information was obtained by appellant, even long after the levy of writ of attachment, it would prove "a state of his mind on September 12" (Tr. p. 189). In other words, information obtained at a later date would be evidence of actual knowledge on the part of the appellant on September 12, 1949.

The Court also indicated that the financial statement (Defendants' Exhibit "D") was practically of no value and didn't mean anything and should not have been relied upon, but inferred that a financial statement should have been a warning or given reasonable grounds to believe that the corporation was then in an insolvent condition (Tr. pp. 203-204).

It is also to be noted that Mr. Ludolph testified from the schedule in bankruptcy long before they were admitted into evidence, and respondent introduced them into evidence upon the statement of the Court "that the schedules should be in" (Tr. p. 135). Obviously an objection to the introduction of said schedule would have been of no avail.

QUESTIONS INVOLVED.

(1) Was the bankrupt corporation Brick O'Gold solvent on September 21, 1949, the date of the attachment?

(2) Was the Court in error in fixing the valuation of the bankrupt's assets as of the time of adjudica-

tion instead of at the time of the attachment, the date of the alleged preference?

(3) Was there sufficient evidence for the finding that the plaintiffs had "reasonable cause to believe that the debtor was insolvent on September 12, 1949?

SPECIFICATIONS OF ERROR RELIED UPON.

I.

The order, judgment and decree of the Court was erroneous in that it decreed that Brick O'Gold, a corporation, was insolvent on the date of payment of the alleged preference.

II.

The order, judgment and decree of the Court was erroneous in that it fixed the valuation of the bankrupt's assets at the time of adjudication instead of the time of the alleged preference.

III.

The order, judgment and decree of the Court was erroneous in that the Court found that the appellants had "reasonable cause to believe that the debtor was insolvent".

IV.

The order, judgment and decree of the Court was erroneous in awarding judgment to the appellee in the sum of One Thousand Seventy-six Dollars and Forty Cents ($1,076.40).

ARGUMENT.

In this proceeding where the trustee in bankruptcy claims a voidable preference, the section of the Bankruptcy Act applicable is *Sec. 60 of the Bankruptcy Act of 1938:*

> "Sec. 60. PREFERRED CREDITORS. (a) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor *while insolvent and within four months* before the filing by or against him of the petition in bankruptcy * * *
>
> (b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, *reasonable cause to believe that the debtor is insolvent.*"

DEFINITION OF INSOLVENCY.

On the question of the definition of "insolvent", the Court's attention is directed to Chapter 1, Subdivision 19 of the Bankruptcy Statutes of 1938, reading as follows:

> "(19) A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts."

FAIR VALUATION OF PROPERTY.

Collier on Bankruptcy, Vol. 1, p. 22:

"Fair valuation has been held to be the present market value, and not the amount which he might realize from a forced sale of the property. (Citing a number of cases.) The fair 'market value' of assets is that value which the debtor himself might have realized thereon if permitted to continue in business. The value of the property as part of the bankrupt's business as a 'going concern' should be considered rather than the value after bankruptcy has intervened and the property has ceased to be productive." (See, also, *Jarvis v. Bell,* 146 Atl. Rep. 153, and *Remington on Bankruptcy,* 4th Ed., Sec. 2264.)

REASONABLE CAUSE TO BELIEVE THAT THE DEBTOR IS INSOLVENT.

The Court's attention is directed to the following cases in point:

Cate v. Certain-teed Prod. Corp., 23 Cal. (2d) 444, at 452-453.

Facts: Defendant knew that the debtor's account was over four months delinquent and did not ship any materials to it for that reason; that reports from Dun & Bradstreet showed the bankrupt was slow in paying its obligations, one account being over six months in default, and advised defendant that the debtor was going to have a bulk sale of its stock in trade; that the defendant contacted the debtor to obtain a settlement and found the latter's place under

attachment; that the check given in settlement was postdated and was not paid when presented to the bank on two successive occasions because of insufficient funds. Defendant made insistent demands for payment.

The Court states:

"It may be inferred from the evidence that the lack of funds to pay the check was not necessarily an indication of insolvency but rather that the debtor's collections on his accounts receivable were slow and hence that the debtor was short of ready cash. Shortage of cash would not necessarily indicate to a reasonably prudent business man that the aggregate of the debtor's property, exclusive of that which he may have transferred with intent to hinder or delay his creditors was not at a fair valuation sufficient to pay his debts."

Citing the case of:

Grant v. First National Bank, 97 U.S. 80 (24 L. Ed. 971).

"Some confusion exists in the cases as to the meaning of the phrase, 'having reasonable cause to believe such a person is insolvent.' Dicta are not wanting which assume that it has the same meaning as if it had read, 'having reasonable cause to suspect such a person is insolvent.' But the two phrases are distinct in meaning and effect. It is not enough that a creditor has some cause to suspect the insolvency of his debtor; but he must have such a knowledge of facts as to induce a reasonable belief of his debtor's insolvency, in order to invalidate a security for his debt. To make mere suspicion a ground of nullity

in such a case would render the business transactions of the community altogether too insecure. It was never the intention of the framers of the act to establish any such rule. A man may have many grounds of suspicion that his debtor is in failing circumstances, and yet have no cause for a well-grounded belief of the fact. He may be unwilling to trust him further; he may feel anxious about his claim, and have a strong desire to secure it—and yet such belief as the Act requires may be wanting. Obtaining additional security, or receiving payment of a debt, under such circumstances is not prohibited by the law. Receiving payment is put in the same category, in the section referred to, as receiving security. Hundreds of men constantly continue to make payments up to the very eve of their failure, which it would be very unjust and disastrous to set aside. And yet this could be done in a large proportion of cases if mere grounds of suspicion of their solvency were sufficient for the purpose. The debtor is often buoyed up by the hope of being able to get through with his difficulties long after his case is in fact desperate; and his creditors, if they know anything of his embarrassments, either participate in the same feeling, or at least are willing to think that there is a possibility of his succeeding. To overhaul and set aside all his transactions with his creditors, made under such circumstances, because there may exist some grounds of suspicion of his inability to carry himself through, would make the Bankrupt Law an engine of oppression and injustice. It would, in fact, have the effect of pro-

ducing bankruptcy in many cases where it might otherwise be avoided."

Gray v. Little, 97 Cal. App. 442, at page 446:

"The fact, alone, that a creditor knows his debtor to be financially embarrassed and is pressing for a payment of his claim, is not sufficient to charge him with having reasonable cause to believe his debtor to be insolvent. Mere suspicion that the debtor may be insolvent is not sufficient to render payments received by a creditor voidable as preference, but he must have such knowledge of facts as to induce a reasonable belief of insolvency."

Citing the following cases:

Sharpe v. Allender, 170 Fed. 589;

Page v. More, 179 Fed. 988;

Bassett v. Evans, 253 Fed. 522;

City National Bank v. Slocum, 272 Fed. 11;

Homan v. Hirsch, 106 Or. 982 (211 Pac. 795);

Grant v. National Bank, 97 U.S. 80 (24 L. Ed. 971);

In re Campion, et al., 256 Fed. 902.

See, also:

Wrenn v. Citizens Nat'l Bank, 47 A.B.R. 115 *et seq.*

Miceli v. Morgano, 36 Fed. (2d) 507.

Facts: The debtor was unable to pay upon demand; one of the debtor's notes was protested; the debtor sought to raise money by obtaining endorsements on notes by creditors.

Held: Mere suspicion of insolvency is not enough.

In re Salmon, 249 Fed. 300.

Facts: Debtor complained of being in financial difficulties.

Held:

"The law is well established that, even if the creditor entertains doubts concerning solvency of the debtor, it is not enough. He must have a knowledge of such facts as will carry him beyond this and furnish a reasonable ground to believe that the judgment will give him preference."

In re Wolf Co., 164 Fed. 448.

Facts:

"It was plain that the company was in embarrassed circumstances. Its debts were known to be large, its operations extended, and some of them, at least, unprofitable, and new capital was needed to carry on the business."

Held:

"A creditor of a bankrupt, who is put on inquiry as to the solvency of the debtor, was not for that reason charged with notice of facts which could only be learned from intimate and inaccessible sources, such as the books of the bankrupt."

Stucky v. Masonic Savings Bank, 108 U.S. 74.

Held:

"A creditor, dealing with a debtor, whom he may suspect to be in failing circumstances, but of which he has not sufficient evidence, may receive payment without violating the law. He may

be unwilling to trust him further; he may feel anxious about his claim; yet such belief as the Act requires may be wanting."

Valley National Bank v. Westover, 112 Fed. (2d) 61.

Facts: The bank knew that the bankrupt was delinquent on another claim. And it had refused earlier to make the debtor a loan, but only because the requested loan was considered too large for the capitalization of the bankrupt.

Held: The lower Court held for the trustee. Judgment was reversed.

BURDEN OF PROOF.

The burden of showing that the person receiving the preference had knowledge or reasonable cause to believe that the debtor is insolvent is upon the trustee.

Collier on Bankruptcy, Vol. 2, p. 1328.

"The law presumes that such payments are legal and the burden of proof is on the trustee, seeking to recover them, to overcome this presumption and establish the essential elements of a voidable preference." Citing a great number of cases in the Federal Courts.

Collier on Bankruptcy, Vol. 2, p. 1330.

"All this must be done by a fair preponderance of all the evidence in the case, and where infer-

ences from proved facts are to be drawn, the rule obtains that if two inferences of substantially equal weight may reasonably be drawn from the proved facts, then that inference shall prevail which sustains the transfer or security. This burden may be shifted to the person to whom the transfer was made, where it appears that the parties are relatives and the circumstances were such as to put the transferee upon his guard."

Remington on Bankruptcy, 4th Ed., Sec. 2259. "The trustee * * * must prove the truth of each of his allegations necessary to set forth a cause of action * * * the general rule is that fraud must be made out by a preponderance of the evidence, which should be so clear and strong as to preponderate over the general and reasonable presumption that men are honest and do not ordinarily commit fraud or act in bad faith."

See, also:

In re Locust Building Company, 299 Fed. 756.

Remington on Bankruptcy, 4th Ed., Sec. 2290. "The complaint * * * and the proof must show that the bankrupt was at the time insolvent and an 'allegation' (or proof) * * * that the bankrupt was in failing circumstances and unable to meet his debts are insufficient * * * such is not equivalent to insolvency. * * * The insolvency *must* be proved as of the date of the transfer."

Trumlin v. Bryan, 165 Fed. 166.

"The burden of proof is on the complainant, and unless he shows by sufficient evidence the ele-

ments of avoidable preference, he is not entitled to recovery. He must prove that * * * the person receiving the payment or to be benefited thereby had reasonable cause to believe that it was thereby *intended to be given a preference.*"

OBTAINING SUBSEQUENT KNOWLEDGE IS IMMATERIAL.

Martin v. Bigelow, 7 A.B.R. 218, at 220.

"To say of a man that he is in failing circumstances or that he is unable to pay all of his debts in full * * * is quite a different thing from alleging that his property taken in a fair valuation is not sufficient in amount to pay his debts; and his adjudication as a bankrupt on March 11, 1901, does not relate back and establish a fact of his insolvency in the preceding November."

Wrenn v. Citizens National Bank, 47 A.B.R. 115 *et seq.*

"The fact that the depositor's balance in a bank was insufficient to meet his note when it came due was not proof of his insolvency * * * neither may his solvency on that date be proven by his insolvency at a later date. * * * It is not enough that a creditor has some cause to suspect the insolvency of his debtor, but he must have some knowledge of the facts as to induce a reasonable belief of his debtor's insolvency * * * subsequent knowledge of a creditor is not material, and it does not matter what the debtor knew."

THE BANKRUPTCY SCHEDULES WERE IMPROPERLY ADMITTED IN EVIDENCE.

Remington on Bankruptcy, 4th Ed., Sec. 2260. "The schedules of a bankrupt are inadmissible against the transferee as they are not his admissions. Schedules were admitted for the purpose of showing insolvency of debtor at the time * * * they are hearsay as against the defendant, and the defendant is not bound by them."

CONCLUSION.

Taking the points in their chronological order, it therefore follows:

(1) What knowledge was there on the part of the appellant on the date of the levy of the writ of attachment, as to the insolvency of the debtor? The mere fact that at a later date it developed that because the debtor was forced into bankruptcy and his assets thereby dwindled to naught, does not and cannot relate back to the date of the levy of writ of attachment. Unless the trustee, by a preponderance of the evidence, proves each element of the preference to the effect that on that date the appellant must have known from the evidence and facts presented to him that the debtor was a bankrupt, then the trustees has not proven his case. Certainly there was no reason for the appellant *not* to rely upon the financial statement

as presented to him, showing the financial status of the bankrupt on the date of the attachment.

Dated, San Francisco, California,
June 27, 1951.

Respectfully submitted,
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